MOODY'S
INVESTORS SERVICE

Credit Opinion: British Columbia, Province of

Global Credit Research - 04 Apr 2013

Canada

Ratings

Category	Moody's Rating
Outlook	Negative
Issuer Rating	Aaa
Bonds	Aaa
Commercial Paper	P-1

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Key Indicators

British Columbia, Province of (Year Ending 3/31)	2010	2011	2012	2013F	2014B
Net Direct and Indirect Debt as a % of Revenue	75.9	75.4	79.9	87.4	92.8
Net Direct and Indirect Debt as a % of GDP	14.8	14.8	15.4	16.5	17.7
Cash Financing Surplus (Requirement) as a % of Revenue	(12.8)	(3.8)	(6.0)	(9.2)	(6.3)
Consolidated Surplus (Deficit) as a % of Revenue	(4.8)	(0.6)	(4.4)	(2.9)	0.4
Total Interest Expense as a % of Revenue	4.4	4.1	4.1	4.0	4.0
Intergovernmental Transfers as a % of Revenue	18.2	19.6	18.4	17.0	16.9
Real GDP Growth (%) [1]	3.2	2.8	1.9	1.6	2.2

[1] Corresponds to calendar year. 2012 to 2014 are projections from budget.

Opinion

SUMMARY RATING RATIONALE

The Province of British Columbia's Aaa issuer and debt ratings are supported by the province's strong fiscal flexibility and track record of prudent fiscal management. The significant debt reduction efforts of the years leading up to the 2008-09 recession put British Columbia in a relatively stronger position to face recently recorded and anticipated deficits and increases in debt burden; the province's net direct and indirect debt as a percentage of revenues declined to as low as 64% at March 31, 2008 from a previous peak of 104% at March 31, 2003, before starting to increase as a result of the economic downturn. Net debt as a percentage of revenues measured 80% of revenues at March 31, 2012. Nevertheless, the province's debt burden remains manageable given its credit strengths and high debt affordability given the current low interest rate environment, which allows the province to issue long-term debt bearing historically low coupons. Furthermore, British Columbia's large and diversified economy is another source of credit strength that supports the Aaa rating. Moody's also assigns a Prime-1 (P-1) rating to the province's commercial paper program.

National Peer Comparisons

While all Canadian provinces have strong ratings, with a rating range of Aaa to Aa2, British Columbia's Aaa rating is

the highest assigned by Moody's. The institutional framework in which Canadian provinces operate affords a large degree of revenue and expense flexibility, supporting a higher debt burden at an equivalent level of credit risk and representing a key source of credit strength for British Columbia. Furthermore, strong fiscal management and performance in recent years enabled British Columbia to reduce its debt burden to a level that is below the median of Canadian provinces, supporting an even higher degree of fiscal flexibility than most other provinces.

Credit Strengths

Credit strengths for British Columbia include:

- Track record of prudent fiscal planning and of managing fiscal pressures effectively

- Mature institutional framework providing considerable fiscal policy flexibility to adjust revenues and expenses to meet fiscal challenges

- Large and diversified economy supporting a productive tax base

Credit Challenges

Credit challenges for British Columbia include:

- Expense and revenue pressures constraining fiscal outcomes in the near term along with cash financing deficits leading to continued increases in debt

Rating Outlook

The negative outlook reflects the risks to the province's ability to reverse the recent accumulation in debt given a softened economic outlook, weaker commodity prices and continued expense pressures. A return to a stable outlook on the Aaa rating would require an achievement of the province's fiscal targets that stabilizes and ultimately reverses the recent accumulation in debt over the medium term.

What Could Change the Rating - Down

Should the government's resolve to achieve fiscal redress diminish and/or if the province is unable to stabilize and then reverse the accumulation in debt, then downward rating pressure could emerge. Furthermore, if debt affordability were to deteriorate due to higher than expected increases in debt levels or a significant rise in interest rates, the province's fiscal flexibility would be reduced, exerting downward pressure on the rating.

DETAILED RATING CONSIDERATIONS

The ratings assigned to the Province of British Columbia combines the baseline credit assessment (BCA) for the province and the likelihood of extraordinary support coming from the federal government in the event that the province faced acute liquidity stress.

Baseline Credit Assessment

The Province of British Columbia's BCA of aaa reflects the following factors:

Financial Performance and Debt Profile

The deficit for the 2012-13 fiscal year is now projected to be C$1.2 billion (2.9% of revenues), compared to C$1.0 billion (2.2% of revenues) forecast in the 2012-13 budget and C$1.5 billion estimated in the second quarter update released in November 2012. Revenues for the fiscal year were significantly impacted by a C$0.5 billion downward revision to natural resource revenues, primarily due to continued depressed natural gas prices and lower production, along with a delay in the sale of the province's Little Mountain property. In addition, the economic forecast was also revised down to 1.6% in 2013, down from 2.2% in the 2012-13 budget.

The slower growth outlook is also impacting the outlook for 2013-14. Despite the increased deficit projection for 2012-13 and lower expected near term growth, the province reaffirmed, in its 2013-14 budget, its plan to reach a balanced operating budget in 2013-14, as required in its legislation. For 2013-14, the surplus is projected to be just C$197 million (after forecast allowances), or 0.4% of revenues. The projected surplus increases to C$211 million (0.5% of revenues) and C$460 million (1.0% of revenues) in 2014-15 and 2015-16 respectively. In the medium-term fiscal forecast, consolidated revenue growth is forecast to grow at a compound annual rate of 3.0% over

2013-14 through 2015-16, reflecting the province's expectation of subdued growth and weak commodity prices, partially offset by new revenue measures. Meanwhile, expense growth is projected to grow at a muted 1.7% over the same period. Specifically, healthcare and education expenses are projected to increase by a CAGR of 2.6% and 0.7%, respectively, over the fiscal plan. Though this year is an election year, there was little new spending announced. The budget did not pass before the election, which is legally scheduled for May 2013. Currently, by law, the budget must be presented to the Legislative Assembly within ninety days after the post-election appointment of the Executive Council (Cabinet); as such a new budget may be presented in the summer.

British Columbia's plan to contain expense growth will be achieved through continued compensation restraint and efficiencies and a restructuring of some departments. The province is looking to moderate healthcare spending, the largest program spending area, through improvements and efficiencies, such as lowering generic drug costs, performance-based incentives, capping fee for services and integrated lab services, amongst other initiatives. With this, the province is looking to bring down health spending to 2.6% annual growth, from over 5% the eight years previous. The province is also looking to other ministries and crown corporations to control expenses and achieve spending reductions. Primarily through attrition, the size of the British Columbia Public Service is also expected to decrease over the forecast horizon.

Revenue measures announced in the budget include several tax measures: a two-year temporary increase in personal income tax rates for high-income earners, a one-year roll forward of the one percentage point increase in the general corporate income tax rate originally slated for 2014-15, an increase in tobacco taxes, phase out of certain light industrial property tax credits and an increase in the Medical Services Plan premium starting in January 2014. In addition to these tax measures, the revenue forecast also includes a number of asset sales. Following a detailed inventory review of government properties in 2011, the province identified a number of properties it would release for sale. The province expects that these properties will generate C$350 million (0.8% of revenues) in 2013-14 and C$150 million (0.3% of revenues) in 2014-15. Disposing of surplus properties, often with associated operating costs, would appear to make sense, however, these one-time sales cannot be relied on to resolve structural budget imbalances. While the revenues anticipated through these sales are significant and there are risks with respect to the timing and proceeds from the sales, the province has included some prudence in its projections using assessed values from 2010 that are likely lower than current market values.

Prudence is also built in elsewhere in British Columbia's budget forecasts, as the province's 2013 and 2014 economic forecasts remain lower than those of its Economic Forecast Council, and contingencies of C$675 million and forecast allowances of C$750 million are built into the projections for the three year fiscal plan. British Columbia has a strong track record of meeting budget targets and will need to maintain this resolve and discipline to ensure that deficits arising from the recent economic downturn remain temporary and do not impair the province's finances on a permanent basis, particularly given the softened economic outlook. Should fiscal discipline be lost and/or the province's debt burden and debt service ratios increase more than on temporary basis, this could apply pressure on the province's rating.

With the posting of operating deficits in recent fiscal years along with significant capital expenditures, the province increased its net debt to C$33.5 billion, or 80% of revenues, at March 31, 2012, a level slightly higher than the previous year. Due to the significant debt reduction achieved by the province over the last decade, however, the province faced the recent downturn with improved fiscal flexibility and has been able to absorb the recorded and anticipated increases in debt burden. Between 2003-04 and 2007-08, the absolute stock of provincial net direct and indirect debt was reduced by C$4.1 billion to C$25.6 billion, falling from roughly 101% of revenues to 64% of revenues. With cash financing requirements expected over the next three years, the province's debt burden is expected to increase moderately to roughly 97% of revenues in 2015-16.

Despite the recent and anticipated increases in debt burden, the considerable debt reduction achieved since 2003-04 has given the province sufficient flexibility to absorb these increases in debt without significant and permanent damage to its financial position. We believe that the increase in British Columbia's debt is reversible, though the province will need to maintain its resolve to achieve fiscal redress and ensure that the debt burden stabilizes and ultimately declines.

British Columbia's debt burden, nevertheless, is expected to remain affordable. Adjusted interest payments, which consumed 4.1% of revenues in 2011-12, are expected to remain relatively stable over the planning horizon--a level that remains lower than most Canadian provinces and preserves a high degree of fiscal flexibility.

Governance and Management

British Columbia displays strong governance and management factors. In recent years, the province's multi-year

fiscal plans have been based on prudent assumptions and practices, such as the use of forecast allowances and contingencies to help insure against unforeseen in-year fiscal developments. Fiscal management measures are supported by comprehensive and transparent financial reporting that is typical of governments in advanced industrial economies.

Economic Fundamentals

After trailing the national average in real economic growth through the latter half of the 1990s and the early part of the 2000s, the British Columbian economy outperformed the Canadian economy in recent years. The strong performance recorded since the early 2000s reflects increases in commodity prices and a booming construction sector, partially offset by difficulties in the province's forestry industry. Moreover, a more competitive tax regime and a number of regulatory changes have supported increased investment in the province, a strong labour market and robust growth in personal income.

After contracting 2.5% in 2009, the British Columbian economy grew by 3.2% in 2010 and 2.8% in 2011 and an estimated 1.9% in 2012. Employment grew by 1.7% in 2012, and the unemployment rate declined to 6.7%, from 7.5% a year earlier. Retail sales growth remains modest, and the housing sector appears to be slowing down; home sales and home price growth have moderated, particularly in the City of Vancouver, which saw robust growth over recent years but has seen home price declines over the past year. Growth is projected to remain modest over the near term, with provincial government forecasts projecting growth of 1.6% in 2013 and 2.2% in 2014. This is lower, however, than forecasts of the Economic Forecast Council, which projects growth at 2.1% and 2.5% in 2013 and 2014, respectively.

Institutional Framework

The Province of British Columbia, like all Canadian provinces, enjoys significant flexibility in its financial management. Compared to their counterparts in other countries, such as the German Länder and the Australian states, Canadian provinces enjoy far greater autonomy in terms of both the spending and revenue sides of their budgets. Unfettered access to a broad range of tax bases and the ability to alter expenditure programs provide Canadian provinces with substantial flexibility to meet fiscal challenges.

Extraordinary Support Considerations

While British Columbia's baseline credit assessment of aaa already places the province in the Aaa rating bracket, Moody's also considers the likelihood of extraordinary support coming from the federal government (Canada, rated Aaa, stable) to prevent a default by the province, should this extreme situation ever occur. The high likelihood of support reflects Moody's assessment of the federal government's incentive to minimize the risk of potential disruptions to capital markets if British Columbia or any province were to default. It also indicates a moderately positive federal government policy stance as illustrated by the flexibility inherent in the system of federal-provincial transfers.

Output of the Baseline Credit Assessment Scorecard

In the case of British Columbia, the BCA matrix generates an estimated BCA of aa1, close to the rating committee's assigned BCA of aaa. The matrix-generated BCA of aa1 reflects (i) an idiosyncratic risk score of 2 (presented below) on a 1 to 9 scale, where 1 represents the strongest relative credit quality and 9 the weakest; and (ii) a systemic risk score of Aaa, as reflected in the sovereign bond rating for Canada.

The idiosyncratic risk scorecard and BCA matrix, which generate estimated baseline credit assessments from a set of qualitative and quantitative credit metrics, are tools used by the rating committee in assessing regional and local government credit quality. The credit metrics captured by these tools provide a good statistical gauge of stand-alone credit strength and, in general, higher ratings can be expected among issuers with the highest scorecard-estimated BCAs. Nevertheless, the scorecard-estimated BCAs do not substitute for rating committee judgments regarding individual baseline credit assessments, nor is the scorecard a matrix for automatically assigning or changing these assessments. Scorecard results have limitations in that they are backward-looking, using historical data, while the assessments are forward-looking opinions of credit strength. Concomitantly, the limited number of variables included in these tools cannot fully capture the breadth and depth of our credit analysis.

ABOUT MOODY'S SUB-SOVEREIGN RATINGS

National and Global Scale Ratings

Moody's National Scale Ratings (NSRs) are intended as relative measures of creditworthiness among debt issues and issuers within a country, enabling market participants to better differentiate relative risks. NSRs differ from Moody's global scale ratings in that they are not globally comparable with the full universe of Moody's rated entities, but only with NSRs for other rated debt issues and issuers within the same country. NSRs are designated by a ".nn" country modifier signifying the relevant country, as in ".mx" for Mexico. For further information on Moody's approach to national scale ratings, please refer to Moody's Rating Methodology published in October 2012 entitled "Mapping Moody's National Scale Ratings to Global Scale Ratings".

The Moody's Global Scale rating for issuers and issues allows investors to compare the issuer's/issue's creditworthiness to all others in the world, rather than merely in one country. It incorporates all risks relating to that country, including the potential volatility of the national economy.

Baseline Credit Assessment

Baseline credit assessments (BCAs) are opinions of entity's standalone intrinsic strength, absent any extraordinary support from a government. Contractual relationships and any expected ongoing annual subsidies from the government are incorporated in BCAs and, therefore, are considered intrinsic to an issuer's standalone financial strength.

BCAs are expressed on a lower-case alpha-numeric scale that corresponds to the alpha-numeric ratings of the global long-term rating scale.

Extraordinary Support

Extraordinary support is defined as action taken by a supporting government to prevent a default by a regional or local government (RLG) and could take different forms, ranging from a formal guarantee to direct cash infusions to facilitating negotiations with lenders to enhance access to needed financing. Extraordinary support is described as either low (0% - 30%), moderate (31% - 50%), strong (51% - 70%), high (71% - 90%) or very high (91% - 100%).

Rating Factors

British Columbia, Province of

Baseline Credit Assessment	Score	Value	Sub-factor Weighting	Sub-factor Total	Factor Weighting	Total
Scorecard						
Factor 1: Economic Fundamentals						
Regional GDP per capita/national GDP per capita (%)	7	93.66	70%	5.2	20%	1.04
Economic volatility	1		30%			
Factor 2: Institutional Framework						
Legislative background	1		50%	1	20%	0.2
Financial flexibility	1		50%			
Factor 3: Financial Performance and Debt Profile						
Gross operating balance/operating revenues (%)	5	1.77	12.5%	3	30%	0.90
Interest payments/operating revenues (%)	5	4.14	12.5%			
Liquidity	1		25%			
Net direct and indirect debt/operating revenues (%)	5	79.90	25%			
Short-term direct debt / total direct debt (%)	1	7.60	25%			
Factor 4: Governance and Management - MAX						
Risk controls and financial management	1			1	30%	0.30
Investment and debt management	1					
Transparency and disclosure	1					
Idiosyncratic Risk Assessment						2.44(2)

Systemic Risk Assessment						Aaa
Suggested BCA						aa1